No. 12,806

In the United States Court of Appeals for the Ninth Circuit

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
WESTERN CONSTRUCTION COMPANY, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
ALBIN JOHNSON, RESPONDENT

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
J. A. JOHNSON, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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"QUESTIONS PRESENTED"

I. Whether the Limited Partnership Western Construction Company constituted an association taxable as a corporation.

II. In the alternative if Western Construction Company is held not to be taxable as a corporation then whether Western Construction Company was a partnership consisting only of the three general partners or, on the other hand, whether the Tax Court properly recognized the children of the three general partners as members of the firm in addition to their respective Fathers, the General partners.

The two questions above set forth are the questions presented in the brief of appellant on Page 5. Actually, the two questions were the questions when the matter was presented to the trial court. Since the trial court, the Tax Court of the United States, found, however, that the parties to the Limited Partnership agreement here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business as a partnership and that it was not an association taxable as a corporation (R. 681-682). Then the questions presented to this appellant court must be amended to read as follows:

I.

Was the Tax Court of the United States, the trial court herein, *clearly erroneous* in finding as follows: That the Limited Partnership, Western Construction Company, did not constitute an association taxable as a corporation and,

II.

Was the Tax Court of the United States, the trial court herein, *clearly erroneous* in finding that the parties to the Limited Partnership agreement here involved formed a bona fide partnership and truly in-

tended to join together for the purpose of carrying on the business as a partnership.

"SUMMARY OF ARGUMENT"

In general the appellee will follow the outline of the appellant's Brief in order to answer issue for issue the matters as they are raised by the appellant. However, the appellee wishes to point out in the very beginning that the Commissioner of Internal Revenue, the petitioner or appellant herein, stresses as his first question the contention that the Western Construction Company is an association and therefore taxable as a corporation. And, most of the argument in Petitioner's brief deals with this question. The fact that the trial court, The Tax Court of the United States, has definitely found that the respondents are a bona fide partnership is completely overlooked and ignored by Petitioner. Therefore, in the very beginning of Respondents' brief respondents wish to call to the attention of this court that a Limited Partnership is in itself an entity entitled to judicial respect. It is not just a collection of individuals in a scrambled category into which have been conveniently dumped all manners of trust, joint stock associations, voluntary associations, inter-insurance exchanges and many other organizations without definite entity, form or design. This court will take judicial recognition of the fact that a partnership is perhaps the oldest business entity composed of more than one individual known to the common law or even to more ancient jurisprudence. A Limited Partnership, of course, is a more modern modification of the ancient partnership. It exists in uniform statutory form in 32

states* of the Union and many of the remaining states will no doubt adopt it in the very near future.

We mention this historical background for the reason that the Petitioner deliberately ignores it, adulterating the meaning of partnership by following a definition that loosely construes a partner to be a member of a syndicate group, pool, joint adventure or organization. It will be noted, too, that with the exception of the *Glensder Textile Co. v. Commissioner*, 46 B.T.A. 176, case, that most of the cases, with few exceptions, are cases dealing with trusts of different kinds and not partnerships in the true sense of the word.

*See Uniform Laws Annotated, Vol. 8, 1950 Cumulative Annual Pocket Part.

At the very outset, therefore, of Respondent's brief, respondent wishes to call the court's attention to its own feeling for that dignified term of human participation in business which through the centuries is known as a "partnership," and which should have an integrity and respect all of its own. The feeling of this court was expressed in the *Bloomfield Ranch v. Commissioner* case reported in 167 F.(2d) 586 on Page 590 wherein Judge Garrecht speaking for the court said:

> "We do not think that the Federal Court in decisions involving the identity of an organization as a partnership under the Internal Revenue Code have wilfully ignored or denied the basic concept of a partnership under general principles of law."

Judge Garrecht goes on further to say:

> "Just as an 'association' has been defined to im-

ply associates and entering into joint enterprise so does a partnership or joint enterprise imply an association and entering into a joint enterprise. *But the latter association conceives the intentional combination and joint endeavor of the parties interested in a common enterprise for their mutual benefit and not merely the appearance of combination or collection action by accident.*" Emphasis ours.

This court, also, in *Commissioner v. Gerstle*, 95 F. (2d) 587, stressed the same point and recognized the importance of intentional joint action and combination of efforts in the undertaking therein involved. Several years later Mr. Justice Frankfurter in a concurring opinion in *Commissioner v. Culbertson*, 337 U. S. 735, on Page 750, lead the way for many similar expressions that this court earlier stated as above mentioned.

While the Culbertson case is mainly cited in Petitioner's brief as setting forth a test for the bona fides of a partnership, nevertheless, Respondents believe that Mr. Justice Frankfurter's words are just as applicable to the first question here involved, to-wit: Whether the Limited Partnership Western Construction Company constituted an association taxable as a corporation and whether the trial court was clearly erroneous in determining that said Limited Partnership did not constitute an association taxable as a corporation.

We quote from Justice Frankfurter:

"The court today reaffirms this reliance by its quotation from the Tower case. The final sentence the portion quoted underlines the fact that the

court could not purport to announce a special concept of 'Partnership' for tax purposes differing from the concept that rules in ordinary commercial law cases. The sentence is: 'We see no reason why this general rule should not apply to tax cases where the Government challenges the existence of a partnership for tax purposes." 327 U. S. 287.

Justice Frankfurter goes on further to say, on page 753:

> "The need for guarding against misuse of the outward form of a partnership as a device for obtaining tax advantages is properly satisfied by reliance on the vigilance of the Tax Court, not by distorting the concept of partnership,"

and, on Page 754, Mr. Justice Frankfurter says this:

> "We should leave no doubt in the minds of the Tax Court, of the Courts of Appeal, of the Treasury and of the Bar that the essential holding of the Tower case is that there is no reason 'Why the general rule' by which the existence of a partnership is determined 'Should not apply in tax cases where the Government challenges the existence of a partnership for tax purposes.' "

The point respondents make is that the Petitioner in this case is trying to make a special concept of 'Partnership' for tax purposes, not alone in the test of the bona fides of the partnership but in this instance as refers to Question No. I in trying to dilute a partnership into an association. Chief Judge McGruger in the case of *Barrett v. Commissioner of Internal Revenue*, 185 F.(2d) 150, in a concurring opinion says:

> "So far as I can see this notion was utterly devoid of statutory basis (this so-called new con-

cept of a partnership for income tax purposes) as is apparent from a mere reading of Internal Revenue Code 181, 182 and 3797, 26 U. S. C. A. 181, 182, 3797. As I read Commissioner of Internal Revenue v. Culbertson, supra, the effect of that case is to sweep this earlier notion into the discard. This is more sharply pointed up perhaps in the concurring opinion by Mr. Justice Frankfurter, but the same viewpoint is discernable from a reading of the majority opinion as a whole. Thus the opinion of the court points out that the evidence in the particular case must be examined to determine whether it is 'Sufficient to satisfy ordinary concepts of partnerships.' " 337 U. S. at Page 739.

Again at (Id) 741, 742, quotes with approval what has been said in the earlier case of *Commissioner of Internal Revenue v. Tower*, 1946, 327, U. S. 280,

> "That when an issue is presented in an Income Tax case, as to whether a family partnership is real 'The inquiry must be whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both, and their intention in this respect is a question of fact to be determined from testimony disclosed by their agreement considered as a whole and by their conduct at execution of its provisions." *Brennen vs. London Assurance Company*, 113 U. S. 51; *Cox vs. Hickman*, 8 H.L. CAS, 268. "We see no reason why this general rule should not apply in tax cases where the Government challenges the existence of a partnership for tax purposes."

The Judge concluded:

> "On the record as a whole it cannot be said that the Findings of Fact of the tax court was clearly erroneous."

Chief Justice Hughes in one of the cases most cited by Petitioners makes a sharp distinction:

> "They had been co-owners but they preferred to become associates and *also not to* become partners." *Guy T. Helvering, Commissioner v. Coleman-Gilbert Associates*, 296 U.S. 369. Emphasis ours.

The respondent cites these cases as support for its theory that The Commissioner in this case is trying to make a special concept of partnership for tax purposes to be termed an association taxable as a corporation.

Now that the Culbertson case has straightened out the matter of the true test of a partnership for tax purposes the Commissioner, respondents believe, is trying to form another special concept of partnership for taxation purposes, to-wit: that of an association taxable as a corporation, and the one important thing missing in the brief of the Commissioner, the appellant, is the fact that the Petitioner ignores that concept of a partnership as defined by Judge Garrecht, *supra.*

In other words, the dignity of the partnership entity itself.

ARGUMENT

Petitioner makes the following tests in deciding the question of whether this partnership has such a substantial resemblance to a corporation that it is taxable as such:

(a) Title vested in a single entity
(b) Centralized management
(c) Continuity
(d) Transferability of beneficial interest, and
(e) Limitation of personal liability.

But in reviewing these tests the respondents urge that this court look through the right glasses or, if you please, through the right end of the telescope. Since the Tax Court of the United States has found that there was a true bona fide partnership then unless the record shows that the Tax Court was clearly erroneous in making such a finding there is no question as to whether there was an association taxable as a corporation, because obviously, it is impossible to have a bona fide partnership and at the same time a loose association taxable as a corporation. We have either one or the other. In our argument, respondents propose to prove to this court that the Tax Court of the United States was not erroneous in any respect in making the findings that the Limited Partnership was a true partnership and was not an association taxable as a corporation. In respect to the association question, the respondents will show to this court that the partnerships in question had title to no property as a single entity; rather that the individuals in the partnership had title to all of the property. That the management was not centralized in one or more persons *acting in a representative capacity* as provided for by Treasury regulations in their test of whether or not a limited partnership is taxable as a corporation. Section 29. 3797-5 of the Internal Revenue Code. That there was

no continuity of the interests of any of the partners after either death or the term of the organization. That there was no transferability of beneficial interest as such transferability exists in a corporate structure and that there was no limitation of personal liabilty except in the very framework of the Limited Partnership Act itself and that only for the limited partners.

With respect to the bona fides of the partnership the respondents will show that the Limited Partnership here in question was not formed for the purpose of reducing taxes. On the contrary, the record discloses that the Limited Partnership was created for valid business purposes without any thought of tax savings. (R. 676.) The idea of forming a Limited Partnership by bringing in the adult members of their families was conceived by the three General Partners after a disastrous contract known as the Coulee Dam job where the three general partners had lost over $100,000.

> "The loss was approximately $100,000 which was all the money the partners had saved during the many years before. While the partners were not forced into bankruptcy they were deeply in debt having pledged their homes and all they owned to the bank and it was necessary that the bonding company complete the Coulee Dam contract." (R. 661.)

This part of the findings of the tax court was not included in the Statement of Facts of the Petitioner.

Argument Relating to Contention of Petitioner That Partnership Was Not a True One.

In the case of *Miller v. Commissioner of Internal Revenue*, 183 F. (2d) 246, in the Sixth Circuit, a state of facts existed that respondents urge was not nearly as bona fide as the present statement of facts. In that case the Petitioner made a gift of a half interest in a chain of drug stores to his wife. She had worked in the stores even before their marriage. The Petitioner and wife then created twelve trusts for equal benefit of three children. The Tax Court held there was no valid partnership for tax purposes, but the Circuit Court of Appeals reversed the tax court as to husband and wife, who were held to constitute a valid family partnership and the case was remanded for decision on question of trust interest established for the minor children. On page 252 the court reviewed the Culbertson Case, 327 U. S. 293, and said:

> "Assuredly this court on review does not weigh the evidence or pass upon the credibility of witnesses, those are the functions of the trier of the facts and for it alone. It is only when there is no substantial evidence to support the findings and decision or on errors of law that the reviewing court may act to set aside the decision of the Tax Court. We find, however, no substantial evidence to support the conclusions that Mrs. Miller was not the owner of a capital interest in the partnership."

Certainly the facts in the case at bar are much stronger in favor of the bona fides of a partnership than were those in the Miller case. Some of the more

recent decisions of the Circuit Court of Appeals on family partnership cases are as follows: *Crosley v. Campbell*, 184 F. (2d) 639, decided October 26, 1950, C.C.A. 7; Partnership entered into by plaintiff and plaintiff's son, was held to be a real bona fide partnership which should be recognized for tax purposes, even though the son was a student at the time, and not active in the business in electrical engineering. The partnership manufactured electrical and radio equipment. The Court said on Page 642, among other things:

> "This court stated in *Greenberger v. Commissioner*, 7th Circuit, 177 Fed. (2d) 990-994, the court in the Culbertson case left no doubt that the predominant factor is the good faith and the legitimate purpose of the parties in forming a partnership."

The court said:

> "The trial court's findings of good faith and legitimate purposes of plaintiff and his son in forming the partnership cannot be ignored or brushed aside. Surely such findings are not clearly erroneous. Under the test laid down in the Culbertson case we think the case was correctly decided by the District Court and judgment is affirmed."

In *Ginsburg, et ux, v. Arnold, et al*, reported in 185 F. (2d) 913, on December 21, 1950, C.C.A. 7, the father gave an interest to his son and two daughters, paid gift tax on transfers. The children did not contribute services to the partnership. The court said:

> "The finding by the trial court to the effect that this was a valid partnership between appellants

> and their children and others who might collaterally attack it but not for tax purposes, cannot be sustained. As Mr. Justice Frankfurter said in his concurring opinion in the Culbertson case, there is no 'Special concept of partnership for income tax purposes differing from the concept that rules in ordinary commercial law of cases.' A family partnership for income tax purposes is to be judged in the light of partnerships in general. A partnership is generally said to be created when persons joined together their money, goods, labor or skill for the purpose of carrying on a trade, business or profession when there is a community of interest in the profits or losses." See *Ward v. Thompson*, 22 Howard 330, 16 L. Ed. 249.

Respondent is citing and quoting from this case for the reason that the facts in this case seem to the respondent to be not nearly as strong as in the case at bar, in regard to the bona fides and the intent and purposes of the partners.

> On pages 915 and 916 * * *the court further said: "That none of the children contributed anything in the way of services, capital or influence to the business directly or indirectly."

The District court was reversed and the partnership held bona fide for income tax purposes.

The Respondent now cites a number of cases for the purpose of showing that there seems to be no divergent view to the rule that the determination of the Tax Court of the United States is conclusive in finding whether or not the partnership is a true partnership. *Cobb v. Commissioner of Internal Revenue*, 185 F.

(2d) 255, decided December 6, 1950, C.C.A. 7. The opinion in this case on Page 258 and 259 stated:

> "The want of substantial contribution to capital non-participation and management and control of the kind and character of contributed services may place a heavy burden on the taxpayer to show bona fide intent, but such determination is conclusive." Partnership recognized for tax purposes.

Cullamer v. Commissioner of Internal Revenue, 185 F. (2d) 146, C.C.A. 4, the court said:

> "The findings of the tax court may be disturbed if, but only if, these findings are clearly erroneous. Since we are unable to find that the decision of the tax court is clearly erroneous, that decision must be affirmed."

In the case of *Barrett v. Commissioner, supra*, the court said on Page 157:

> "In conclusion it will suffice to say that whether ostensible husband and wife partners really and truly intend to join together for the purpose of carrying on business * * * depends in each particular case upon all the pertinent facts; that under established principles this presents a question for the Tax Court in the first instance and that its answer there will not be disturbed unless clearly erroneous."

To same effect is the case of *Nelson v. Commissioner of Internal Revenue*, reported in 184 F.(2d) 649, C.C.A. 8.

It would seem, therefore, beyond dispute that the facts as found by the Tax Court of the United States in

the case at bar were not erroneous in any respect and that this Court should affirm the findings and decision of the trial court that the Limited Partnership was a bona fide and true partnership for tax purposes.

The Petitioner on Page 33 of his brief states:

> "Under such circumstances the finding of the Tax Court majority that all of the parties formed a bona fide partnership and intended to join together for the purpose of carrying on a business partnership is clearly erroneous."

In the face of the decisions just cited, the statement of the Petitioner would seem to be an unwarranted presumption and probably should not be dealt with at great length by respondent herein. Following Petitioner's brief here for a time, the assertion, on Page 33, that there is no change in the operation or management of the business after the formation of the limited partnerships would certainly later on in petitioner's brief seem to confound him when Petitioner claims that there was a representative management thereby making the partnership an association similar in that respect to a corporation. But what he means to imply by the statement at this point is obscure. He goes on to say that the daughters performed no services, and that such services that the sons performed were under the direction of the General Partners. If the intent of the partners in entering into the agreement were truly to form a partnership, certainly the fact as contended for by petitioner would not make any difference and has not made any difference in several cases above cited where the partners did not contribute services

or finances or anything else and the partnership was held to be a true partnership.

But, when appellant comes down to the notes given by the limited partners he gets into a peculiar position. He says that the notes given by the children were not owned or used by the partnership as such but constituted separate assets of the individual general partners to whom they were payable, which, of course, is a fact and should be remembered when petitioner makes his inconsistent argument a little later that limited partners gave nothing for their interest. But, Petitioner seems to ignore conveniently the matter of the use of these notes. The Tax Court found that the possession of these notes was a factor of considerable importance to the financial status of the general partners and through them to the Limited Partnership as Petitioner states again on Page 33 of his brief. But to show how these notes actually worked, we call attention to the testimony of J. A. Johnson (R. 263-264-265). The testimony was given on cross-examination and we think it worthwhile to put it in full in this brief as a footnote.*

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*Q. And by doing that how would the partnership be richer after than they were before?

A. Well, we had $60,000.00 of notes in the partnership, and those notes were good.

Q. But those notes offset equal amounts which you credited to the individual limited partners, didn't they?

A. Well, we were just $60,000.00 better off after we had those notes than we were before. Even though it was not actually in cash, it was in notes, but we were $60,000.00 better off financially than we were before.

Q. You mean that you were better off or the partnership was?

A. The partnership was.

Q. But the notes were given to you individually, weren't they?

A. Yes, but when we signed for bonds and had a note in the bank—we were not in a corporation, you see, we were in a partnership, and

The Petitioner also contends on Page 33 of his brief that because two large Government contracts were partially completed when the limited partnership agreement was executed, that it was error for the Tax Court to have found that the $60,000 credit which the Limited Partners contributed by way of their notes was of any substantial importance to the financial status of the business or of the General Partners. If the Petitioner's counsel had had any experience in the contracting business, it would certainly appear pretty plain

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when we signed on the dotted line, we signed everything away that we had.

Q. When you agreed to give your children some share of that for their notes, you took the same personally for what you gave them, isn't that correct?

A. Well, we still had the same capital.

Q. Now, what do you mean by that?

A. Well, I didn't pay them the cash. They owed me that $6,666 on a note, and I still had the same amount of capital that I had before.

Q. But they owed you that note personally. They didn't owe it to the partnership—your children didn't owe it to the partnership, did they?

A. They owed it to me personally, but I had to sign for the company. We were $60,000.00 better off on account of those notes.

Q. You mean you were, or the partnership?

A. The partnership.

Q. How was the partnership any better off? That is what I want to know.

A. We were $60,000.00 better off.

Q. The notes didn't belong to the partnership.

A. Yes, but—

Q. (interposing); now, wait a minute. You say "yes," but do you mean yes or no. The notes were yours, or were they the partnership's?

A. The notes belonged to me personally because I had borrowed the money personally, but when we came to get a loan, or for our financial purposes, it didn't make any difference whether it belonged to the partnership or whether it belonged to me personally. As a partnership we had to sign on the dotted line, on the notes, or on the bonds, or on any finances that we had to get, we had to sign for it, and we obligated all our capital or all our belongings together when we signed the note.

Q. You mean you, George and Albin did.

A. Yes, sir.

Q. And that was so because you were general partners, isn't that right?

A. Yes, sir.

Q. So when you went to get credit you used all your personal assets and resources in order to get it?

A. That is correct.

to them that about that time the partnership's limited assets would have been severely strained to carry on large contracts and while months later it might have been determined that a profit was made, until the profit was actually collected in the form of money out of retained percentages, etc., this court undoubtedly will take judicial recognition of the fact that carrying on two large contracts with the limited assets that this partnership had to begin with required every cent of money and every possible credit that the partnership could secure.

It will be remembered that the trial court found that on July 30, 1942, an additional $50,000 was borrowed from the bank (R. 670-671), and as J. A. Johnson testified, supra, these notes were used by the general partners in their financial statements for the purpose of obtaining credit. At the time the limited partnership was formed, the general partners owed the bank about $80,000. (R. 581.) While respondent doesn't want to go into the record too much, believing that the court findings are conclusive, nevertheless since Petitioner claims the trial court was clearly erroneous in the findings and cites the notes as an example, respondent wishes to refer to the testimony of Mr. Westly Ogg, Credit Manager for the Seaboard Branch of the Seattle-First National Bank. Mr. Ogg brought with him Petitioner's Exhibit No. 18 which he identified as a financial statement "given us and signed by Mr. J. A. Johnson as part of our confidential record files in support of any accommodation of credit, or otherwise he might request from us." Petitioner's Exhibit 18 shows

that item of $20,000 listed as accounts and notes due from friends and relatives. (R. 480-481.)

The fact that the notes weren't hypothecated is not material. They were used for the purpose of securing credit. If the bank having had enough confidence in the partnership to not require the notes be hypothecated, what difference does that make to the partnership if they obtained the necessary credit without the hypothecation? The fact that in the next year or at least several months later the aggregate profit exceeded $436,000 would not be material or a cause for deciding that the venture was not a bona fide partnership. As the trial court has pointed out

> "They knew that the construction business is subject to heavy losses as well as handsome profits." (R. 671-672.)

It would certainly be unfair to say that when a contract was 40 per cent completed that success was assured and the profits could be distributed on the basis of said 40 per cent completion. Respondent contends that the finding of the trial court that the Limited Partnerships were bona fide partnerships is sustained by all of the evidence and that there is nothing erroneous in the findings and that if the case were tried *de novo* that this court would make the same finding.

Therefore, respondents contend that the finding is conclusive and must be affirmed and if that be so then there is nothing further to be decided for the reason that if the limited partnership is a true and bona fide partnership that obviously this enterprise cannot be an association taxable as a corporation.

However, we will now take up that contention by Petitioner, but in doing so Respondent urges again that this court view the contentions of the Petitioner not from the end of the telescope that sees the pool or indefinite association but from the end of the telescope that visions "*the intentional combination and joint endeavor of the parties interested in the common enterprise for their mutual benefit*" has been formed and that the Tax Court of the United States has so found.

ARGUMENT RELATING TO CONTENTION OF PETITIONER THAT PARTNERSHIP WAS AN ASSOCIATION TAXABLE AS A CORPORATION

In Petitioner's summary of argument on page 20 of his brief, Petitioner states that the mandate of the statute as construed by the highest authority requires taxation of Western Construction Company as an association taxable as a corporation. He goes on to make the argument that this is a question of law and not a review of a question of fact. Respondent does not concede this. As the court said in *Wabash Oil & Gas Association v. Commissioner*, 160 F. (2d) 658, C.C.A. 1, decided in 1947 on Page 660:

> "There seems to be some divergence of views among the Circuits as to the nature of the question. In the Fifth Circuit it was held even before the decision in *Dobson v. Commissioner*, 320 U. S. 489, that the question was one of fact. * * * But in the Sixth and Ninth it seems to have been assumed without discussion that the question was one of law. *Commissioner v. Fortney*, 125 F. (2d) 995, *Helm and Smith Syndicate v. Commissioner*, 136 F. (2d) 440. * * *

However, neither in this case nor in any of the other cases cited by Petitioner had there been a *finding by the trial court* that the organization was *a true partnership.* This finding changes the viewpoint and must change it in this instant matter. Therefore, respondents insist again that there being no error in the finding of the Tax Court of the United States that Western Construction Company was a true partnership for taxation purposes, that, therefore, there is nothing further to argue, as to its corporate resemblance, if any. However, to meet the argument of Petitioner respondents contend that without the decision or finding of the trial court that the organization was a bona fide partnership, that, nevertheless, the additional finding by the trial court that the entity was not that of an association taxable as a corporation also must stand, unless the evidence supporting the finding is clearly erroneous, and respondent believes that it can easily and cogently show this court that there was no error in the finding.

In the case of *Commissioner v. Brouillard,* 70 F. (2d) Page 158, it is said:

> "Where an entity of this kind resembles a corporation in some respects and that of a partnership in others, that frequently being the case, the features of similarity should be compared and the marks of dissimilarity contrasted. The resemblances should be balanced, it should be determined by that method the one to which the enterprise is predominantly akin in the method, mode and form of procedure in the conduct of its business. If it be a corporation, it falls within that category; if

> a partnership it should be placed in that class and should be taxed accordingly."

This is what respondent means by looking into the right end of the telescope. In other words, the respondent believes that the balancing of the resemblances and the comparing of the dissimilarities should begin with the finding by the Tax Court that the particular partnership in this case has been held by the Tax Court to be a valid and true partnership. Therefore, that its dissimilarities to a corporation overbalance any small resemblances which it might have to a corporate structure. The respondent believes that these resemblances are very small and minor as will be pointed out later in this brief.

To begin with Petitioner has taken a Law Review article by one Lloyd M. Smith from the California Law Review, Volume 34, September, 1946, and has followed it very closely. There are many elements that Mr. Smith in a very intelligent, if not realistic, treatise has overlooked. For instance, the joint enterprise feature that respondent has emphasized several times in the first part of his argument. That feeling, as we suggested, that this court had for that warm relationship between persons who engage in a joint endeavor, as Judge Garrecht said:

> "An intentional combination and joint endeavor of the parties interested in a common enterprise for their mutual benefit."

Which joint enterprise, respondents sincerely urge is present in the combination of individuals signing the Articles of Copartnerships in the instant case. This

attitude, or what we have called feeling, is pointed up by a quotation from the testimony which Petitioner sets forth on Page 51 of his brief; that is, the testimony of Winston Johnson, one of the young limited partners, who, said among other things, that he always dreamed of the Western Construction Company being probably one of the largest construction companies in the Northwest. That they had done good work and had gotten a good name for themselves and they didn't see why they couldn't continue, the three boys with the help from their sisters and the husbands of their sisters and even through those husbands like Mr. Ellingson who worked for us as a foreman and he didn't see why in the future the three boys, himself and the rest of them, couldn't continue in this kind of work and he still had ambitions about the company becoming something again.

Petitioner, of course, italicized the use by Winston Johnson of the world *company*, meaning to take technical advantage of the use of that term by the young man and also to show that it would continue after the general partners retired or died. Of course, every member of this respected bench who might have a son while in the practice of law certainly could dream of having that son as a partner with him, and perhaps even a grandson, regardless of whether the first partnership might be terminated with the death of the grandfather and a new partnership by the same name continued in the name of the son and grandson. That is, of course, what was in the mind of this young dreamer, Winston Johnson, not a technical consideration of how the busi-

ness would be kept legally continuing. All through Mr. Smith's article and, of course, copied and emphasized by Petitioner, is a lack of practical consideration of partnerships as they exist in business throughout the United States today. Mr. Smith cites only one case involving a limited partnership and that is the *Glensder Textile Co. v. Commissioner*, 46 B.T.A. 176, and he lightly dismisses the limited partnership form. This respondents urge was a grave error on both Mr. Smith's and Petitioner's part. A form of business organization that is a modern refinement or modification of the original partnership law which in itself has become codified as a Uniform Limited Partnership Act and adopted by so many States of the Union is a living creature of our law and to have it thus lightly disregarded and adulterated into something else *called an association for taxation purposes* is to do exactly what Mr. Justice Frankfurter and Judge McGruder point out was done in the cases following those of *Commissioner v. Lusthaus*, 327 U. S. 293, and that was to form a new and, may we add, strange concept of a partnership.

Peculiarly enough, this was without logical foundation in the very cases that gave rise to the opportunity to form such a strange new concept as Justice Frankfurter pointed out when he said that there was no foundation in either the Lusthaus or Tower cases for this concept. And respondents urge that in *Morrissey v. Commissioner*, 296 U. S. 344; *Swanson v. Commissioner*, 296 U. S. 362; *Helvering v. Combs*, 296 U. S. 365, and *Helvering v. Coleman-Gilbert Associates*, 296 U. S. 369, all companion cases, with the opinions

written by Chief Justice Hughes, that there is not in these cases the basis for this new and unique concept of making a real Limited Partnership into an association taxable as a corporation. That the Commissioner, the Petitioner herein is trying in this case to springboard off the Morrissey case and its companion cases a new concept of tax law just as the Commissioner used the Lusthaus and Tower cases for an unfair base to assess the income of relatives in a partnership to the originator or main partner, simply because of the relationship in most instances. Respondents submit this new concept sought for by Petitioner is even more nebular and impractical than the former concept and much more inequitable and unfair than the concept the Commissioner strove for after the Tower and Lusthaus cases. For instance, in this case the Tax consequences would be as follows: If the partnership were held to be an untrue and unreal one the tax consequences of setting over the income of the limited partners to the general partners would be as set forth in the Footnote 2 on Page 35 of Petitioner's brief as follows: Albin Johnson, \$123,675.85; Ellen Johnson, \$38,467.40; Huldah Johnson, \$39,812.41; George J. Johnson, \$38,828.50, and J. A. Johnson, \$37,903.24, or a total of \$278,687.40, while to find the partnership was an association taxable as a corporation would be to levy a confiscatory deficiency against these respondents in the sum of \$728,832.16.

Therefore, let us look at the Morrissey and companion cases first. In the Morrissey case, supra, the trust was created for the development of a tract of land

through construction of a golf course, club house, with broad powers for purchase, operation and sale of the property. The centralized management was as the court held comparable to the Board of Trustees or Directors of a corporation and was, therefore, representative. The interest in the trust was evidenced by shares, preferred at $100 each, and common shares of no par value. There was provision for the assignment of certificates of interest, there was limitation of liability and continuity of management. It is obvious that its comparison or resemblance, as was said in the case, to a corporation was true in nearly every aspect.

In *Swanson v. Commissioner, supra,* a business trust by co-owners of apartment house property was set up. The receipts to evidence the interest of the beneficiaries representing 100 shares of the par value of $100 each might be transferred by assignment. The agreement provided that the trust could sue and be sued as such and neither the trustees nor the beneficiaries should be personally liable. The trust had succession, was not terminated by the death of a trustee or beneficiary.

In *Guy T. Helvering, Commissioner of Internal Revenue v. E. E. Combs, supra,* a trust was created to finance and drill one oil well and the production and sale of oil. The certificates of beneficial interest were to be issued in approved legal form. Quoting from Page 368 and 369,

> * * * "Entering into a joint undertaking they avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain to corporate organizations."

In the next companion case, that of *Guy T. Helvering v. Coleman-Gilbert Associates, supra,* five persons associated in owning and operating apartment houses, formed a trust to continue for 15 years. Quoting from Page 374 of the court's decision, Headnote 2:

> "* * * They formed a combination to conduct the business of holding, improving and selling real estate with provision for management through representatives with continuity which was not to be disturbed by death or changes in ownership of beneficial interest and with limited liabilities."

We now quote again the words of Chief Justice Hughes which we have used before:

> "*They had been co-owners but they preferred to become associates and also not to become partners.*" Emphasis ours.

Just a few months later, to-wit, in the October term, 1936, the Supreme Court of the United States decided another case involving a trust, the case: *A. A. Lewis v. Commissioner,* 301 U. S., Page 388-389. The court in its decision refers to the Morrissey and companion cases and said:

> "We pointed out that the corporate analogy was evidenced by centralized control, continuity and limited liability, as well as by the issue of transferable certificates and we said that the word 'association' implies associates. * * * There is to be found in the operation of the business (here) no essential characteristic of corporate control — nothing analogous to a Board of Directors or shareholders, no exemption of personal liability, no issue of transferable certificates of interest."

Petitioner does not mention this case in his brief but plainly the Supreme Court of the United States after deciding the Morrissey and companion cases did not intend that a new concept of taxation be launched from those cases and the Lewis case decided soon afterwards is a good signboard that the Court's reasoning in the Morrissey case is not to be extended into the nebulous unreality of the arguments proposed by Petitioner in his brief.

Taking up Petitioner's arguments as he advances them, beginning on Page 31 of his brief, we find him suggesting that a business enterprise which has obtained most of the organizational advantages of incorporation should be taxed as a corporation and that the legislative purpose was clearly to place in the same tax category business organizations essentially of the same character regardless of formal technicality.

Respondent believes that such a comprehensive grouping is altogether erroneous and dangerous. Clearly the legislatures of the different states that have adopted the Uniform Limited Partnership Act did not propose to place this partnership in the same income tax category as a corporation.

Then the Petitioner goes on to list four things which evidently he thinks are essential organizational advantages of incorporation. [1]They are: That it possesses the capacity as a unit to acquire, hold and dispose of property and to deal with its property separate from its members' individual property. The statutes then in force in the State of Washington governing the organ-

ization of Limited Partnerships are listed in a footnote below.

It will be noted that there is no entity possible to be formed under the laws as set forth herein wherein this entity can own property as such, sell it, transfer it, deal in leases or have any other powers that a cor-

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[1] R.R.S. 9966, 9967, 9968, 9971, 9973, 9975.

9966. Limited partnership may be formed. Limited partnership for the transaction of mercantile, mechanical, or manufacturing business may be formed within this state, by two or more persons, upon the terms and subject to the conditions contained in this chapter.

9967. Of whom composed, and liability of members. A limited partnership may consist of two or more persons, who are known and called general partners, and are jointly liable as general partners now are by law, and of two or more persons who shall contribute to the common stock a specific sum in actual money as capital, and are known and called special partners, and are not personally liable for any of the debts of the partnership, except as in this chapter specially provided.

9968. Certificate to be made, acknowledged and filed. The persons forming such partnership, shall make and severally subscribe a certificate, in duplicate, and file one of such certificates with the county auditor of the county in which the principal place of business of the partnership is to be. Before being filed, the execution of such certificate shall be acknowledged by each partner subscribing it, before some officer authorized to take acknowledgments of deed, and such certificate shall contain the name assumed by the partnership and under which its business is to be conducted, the names and respective places of residence of all the general and special partners, the amount of capital which each special partner has contributed to the common stock, the general nature of the business to be transacted, and the time when the partnership is to commence, and when it is to terminate.

9971. Name of firm—When special liable as general partner. The business of the partnership may be conducted under a name in which the names of the general partners only shall be inserted, without the addition of the word "company" or any other general term. If the name of any special partner is used in such firm with his consent or privately, he shall be deemed and treated as a general partner, or if he personally makes any contract, respecting the concerns of the partnership, with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contract he acted and was recognized as a special partner only.

9973. Suits by and against limited partnership—Parties. All actions, suits or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships, in which case all the partners deemed general partners may join therein; and excepting also those cases where special partners are severally liable on account of sums or amounts received or withdrawn from the capital stock, as provided in the last preceding section.

9975. Liabilities and rights of members of firms. In all cases not otherwise provided for in this chapter, all the members of limited partnerships shall be subject to all the liabilities and entitled to all the rights of general partners.

poration possesses as one of its peculiar and necessary characteristics.

A Limited Partnership organized under the laws of the State of Washington as set forth in this brief cannot sue, even in the name of the limited partnership, or be sued as such.

(2) The Petitioner states: "Management of its affairs was centralized in the three general partners acting in a representative capacity." When Petitioner uses "representative capacity" he should be more exact because, obviously, general partners who are personally liable without limitation are not mere representatives of the limited partners and a close examination of the law as set forth in the footnote herein will show that in no sense could the general partners be termed representative. Treasury Regulations 3, Section 29, 3796-5 specifically mentions acting in a representative capacity. It states:

> * * * "If the management of its affairs are centralized in one or more persons acting in a *representative capacity*, it is taxable as a corporation. For want of these essential characteristics, a Limited Partnership is to be considered as an ordinary partnership * * *." Emphasis ours.

Now let us examine into this test of representative capacity. In a corporation the Directors or Trustees are elected for a stated term by the shareholders. This is, of course, the representative capacity meant by the Treasury Regulation. The permanent Edition of Words and Phrases, Volume 37, Page 66, under the phrase "acting in a representative capacity," cites the

case of *VanBrunt and Davis Company v. Herrigan et al*, Supreme Court of South Dakota, reported in 65 N.W. Page 422,

> "The contention of counsel for respondent that partners sued as such are sued in a representative capacity is not tenable. The term 'representative capacity' is a well-understood term and only applies to a party acting for and in behalf of some other party or estate and not for himself personally. When a party sues or is sued in such capacity, it is necessary that the capacity in which he sues or is sued should appear in the title to show the relation between the party and the estate representative and that he is in court not for himself but for the estate he represents. Partners occupy no such position, when suing or being sued they represent themselves only. Any judgment for or against them is rendered for or against them individually and not as a partnership."

This, of course, is exactly in line with the law of the State of Washington as set forth, *supra*. Then in Subdivision Three, Page 31 of his brief, Petitioner goes on,

> "By means of a special agreement and powers conferred in the Limited Partnership certificate continuity of the business was assured notwithstanding the death or the retirement of a general or limited partner."

While there was the following provision in the certificate of Limited Partnership, Petitioner prefers to ignore the law of the State of Washington in existence at the time governing the probate of partnership property. We set out the laws of the State of Washington

in footnote[2] below covering the probate of partnership property.

An examination of these statutes shows that the death of a partner terminates the partnership. No distinction is made between General and Limited Partner. The executor or administrator of the deceased partner is required to make a separate schedule in the

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[2] R.R.S. 1458, 1459, 1460, 1461.

1458. Partnership property—Inventory—Rights of surviving partner. The executor or administrator of the estate of a deceased person who was a member of a copartnership, shall include in the inventory, in a separate schedule, the whole of the property of such copartnership; and the appraisers shall estimate the value thereof and also the value of such deceased person's individual interest in the partnership property.

The whole of the partnership property shall be administered by such executor or administrator, unless the surviving partners shall, within five days from the filing of the inventory, or such further time as the court may allow, apply for the administration thereof. If he so apply, he shall be entitled to administer the partnership property if the court find him to be qualified. If letters of administration be issued to such partner, he shall give such bond as the court may require. He shall be denominated the administrator of the partnership and shall give such notice to the partnership creditors as general administrators are required to give and shall settle the partnership estate in the same manner as is or shall be provided for the settlement of estates or deceased persons except he shall account to the general executor or administrator for the interest of the deceased in the partnership property.

1459. Purchase of interest by survivor—Protection against liabilities. The surviving partner, whether he be administrator or not, shall have the right at any time to petition the court to purchase the interests of such deceased in any or all the personal property of the partnership. Upon such petition being presented it shall be the duty of the court, in such manner as it may see fit, to learn and by order to fix the value of the interest of the deceased over and above all partnership debts and obligations, in such partnership personal property, and the terms and conditions upon which such surviving partner may purchase, and thereafter such surviving partner shall have the preference right for such length of time as the court may fix, to purchase the interest of such deceased partner at the price and upon the terms and conditions fixed by the court.

It shall be the duty of the court to make such orders as it may deem proper or necessary to protect the estate of the deceased against any liability for partnership debts or obligations.

1460. Survivor to operate business. The court shall have authority, in instances where it is deemed advisable, to authorize the administrator of the partnership property to continue to operate any going business pending the settlement of the partnership estate or the purchase by the surviving partner of the interest of the deceased partner.

1461. Survivor failing to act. In case the surviving partner is not appointed administrator of the partnership property, the administration thereof shall devolve upon the executor or administrator and the court shall have power to require the surviving partner to deliver the partnership property and evidence thereof to the administrator or executor.

inventory containing the whole of the property of such partnership. The surviving partnership is given five days from the filing of the inventory to apply for the administration thereof; the survivor is also given the right to purchase the interest of the deceased partner. Also, the court is to take the necessary steps to protect the estate of the deceased against any liability arising out of the partnership. The court has the authority to authorize the administrator of the partnership property to continue to operate any going business pending the settlement of the partnership estate or the purchase by the surviving partner of the interest of the deceased partner.

Therefore, under the laws of the State of Washington applicable to these limited partnerships upon the death of a general partner or of a limited partner, the partnership was automatically terminated. The best that provision X of certificate, printed in footnote, could give to the organization would be to give some time or period of grace while the court wound up the affairs of the partnership through its probate department or arrange for the purchase by a surviving partner of the interest of the deceased partner. This arrangement, however, would also terminate the partnership.

Appellant's brief on Page 53 goes on to state, "that under this certificate the right is given to the business

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Provision X. The entire management of the partnership shall be vested in the three general partners and the right is hereby given to the remaining general partners to continue the business upon the death of retirement of a general partner and the right is also given to the general partners to continue the business upon the death or retirement of any of the Limited Partners hereto. (R. 665-669).

to continue, *i.e.* an organization is created which, like a corporation, need not be interrupted, wound up or liquidated upon the retirement of either a general or limited partner." Now there are authorities, and many of them, beginning with the *Morrissey* case and the companion cases, which hold that the parties' purpose in organizing "was no other than that they formally set forth in the instrument under which their activities were conducted and similar dicta." However, the mere fact that in Paragraph X of the Certificate of Limited Partnership the right is given to the remaining general partners to continue the business upon the death or retirement of a general partner or a limited partner does not mean, of course, that this right expressed in the contract is a *legal right* and if, under the law of the state in which the partnership is organized, no such right could be given, then the provision in the contract is invalid and an invalid covenant or portion of an agreement certainly can't be construed to be valid for tax purposes or any other purpose.

On Pages 54 and 55 of Appellant's brief this subject is discussed. But there is nothing in the discussion, although it existed by statute, *supra*, that shows to the court that the laws of the State of Washington are different than the ones cited and Appellant states on Page 55:

> "There is no reason to suppose that the law of Washington differs although direct authority is lacking."

We don't know why Petitioner put that statement in his brief when in the Respondent's brief in the Tax

Court the statutes of the State of Washington as set forth here were set forth there and the argument of respondent's was set forth in detail as it is here.

Petitioner cites *In re Randall's Estate*, 29 Wn. (2d) 447, on Pages 456-457, 188 P. (2d) 71, which approved an agreement enabling a partnership to continue affording the surviving partner the right to purchase the interest of a deceased partner at a fixed or determinable price. So states the Petitioner on Page 55, but he misleads the court when he says that the decision approved an agreement enabling a partnership to continue. This is true only so far as the partnership was continued under the agreement to purchase, similar to probate law, R.R.S. 1459, *supra*, and we quote the part of the statute controlling:

> "And thereafter such surviving partner shall have the preference right for such length of time as the court may fix to purchase the interest of such deceased partner at the price and upon the terms and conditions fixed by the court."

This gave to the surviving partner only the right to purchase the decedent's interest. It did not allow continuity of the joint venture and that is the misleading inference that Petitioner tries to draw.

In the *Randall Estate* case, *supra*, the Washington Supreme Court simply approved an agreement between partners whereby a surviving partner had the right to purchase the interest of a deceased or withdrawing partner at a price to be determined by a method agreed upon by contract between them. *The issue in the case was the price agreed upon. And whether a fraud had*

been perpetrated. Nowhere in the decision did it do other than uphold the agreement as to the right of a surviving partner to purchase the interest of a deceased partner. *It did not in any way give continuity to the partnership.* That question was not involved.

> ". . . there is no reason to suppose that the law of the State of Washington differs, although direct authority is lacking." . . . *Indeed!*

. Petitioner on the next page runs into himself and admits in anticipation of this argument that the Respondents might argue that Paragraph X of the certificate merely affords the surviving partners the right to continue the business upon partial liquidation, namely, upon paying off the interest of the deceased partner. However, Petitioner again misleads the court because the court isn't informed of the probate law. There cannot be any valid argument that the business could continue upon partial liquidation. *The original partnership couldn't continue at all;* only for such time as might be necessary to liquidate the interest of the deceased or retiring partner. A new partnership with the survivors, if more than one, then begins or a sole proprietorship if only one survived.

Then Petitioner makes an argument that he makes in various parts of his brief that is very unusual in the light of his persistent demand that the court hold the partners to the agreement which they signed. Petitioner says, "similar arrangements are not uncommon in cases of closed corporations upon the decease of stockholders and do not involve termination of the business but only decrease in the capital." Of

course, this is the right of the directors and stockholders of a corporation to make contracts between themselves. The right of any stockholder or group of stockholders in any corporation to make agreements among themselves to dispose of their property, to-wit: the stock in the corporation. The corporation themselves in their Articles of Incorporation do not have provisions that provide for the liquidation of the corporation except term expiration and the corporation isn't in any way liquidated, suspended or dissolved upon the death of one of the stockholders, which is the case in partnerships and was the case in the State of Washington at the time of the limited partnership certificates in this case.

Then Petitioner goes on to say further that the power conferred under Paragraph X of the Certificate need not be construed to be so limited, but on the contrary to comprehend a broader type of continuing arrangement entailing no liquidation as described above. Petitioner knows better than this. Unenforceable covenants in agreements can give no powers that the law itself denies. This is too elementary to cite authorities.

On Page 55 of his brief, Petitioner recommends that the court read the Warner-Fuller Article re: "Partnership agreement for continuation of an enterprise after the death of a partner," in 50 Yale Journal, 202, 204, 211, (1940). The article is indeed interesting. On Page 205 the author speculates upon such an enterprise being continued by surviving partner without the introduction of a successor partner to replace decedent. He suggests that the contract is valid on ordinary con-

tract principles but further surmises that it is "unlikely that the courts will decree specific performance of such agreements. Equity ordinarily will not specifically enforce such contract which involve the exercise of special skills and judgment or demand constant supervision on the courts."

In Footnote 22 to the article the author goes on to say:

> "The reasons which have been advanced for denying specific performance of a partnership agreement among living partners seem to apply with equal force to the situation where a surviving partner is unwilling to continue the business after the death of an associate. It has been said that with respect to the former situation that equity will not enforce a contract requiring the exercise of the business skill and judgment so characteristic of the partnership relation. See *Buck vs. Smith*, 29 Mich. 161-171; *Clark vs. Truitt*, 183 Ill. 239, 245, 55 N. E. 683; 5 Pomeroy Equity Jurisprudence 4th Ed., 4898. If continuation of the business should become impractical for any reason continued performance on the part of the survivor probably would be excused on the theory that the presumed intent of the parties would be to wind up the enterprise in such circumstances even though the subscribed term had not yet expired. See *Clifps Estate*, 135 Mich. 4, 10 (1929) 23, 7 N. Y. Supp. 635, 643; Lindley, Partnership (10th Ed. 1935) 677.

The author in Footnote 10 goes on to say:

> " * * * It seems to have been assumed that a partnership and not an association exists where

> the members operate the business along orthodox partnership lines, although they may have agreed that the enterprise should be continued to the end of the agreed term despite the earlier death of a member."

Appellant then cites *Bloomfield Ranch vs. Commissioner, supra*, Page 592 and *Wabash Oil & Gas Association v. Commissioner*, 160 F.(2d) 658, Certiorari denied 331 U. S. 843; also cites *Poplar Bluff Printing Company vs. Commissioner*, 149 F. (2d) 1016 on the next page.

In the *Bloomfield Ranch v. Commissioner* case which we have cited for another purpose it was held in substance that the continuity of an organization without interruption by death is insured when the term of the enterprise is binding upon the investors, successors, heirs, representatives and assigns. That point, of course is not in the instant case, there being no such agreement whatever and there could not be a valid one under the Washington laws.

In the *Wabash Oil & Gas Association* case it was provided that no party was entitled to dissolution but on the death or bankruptcy of anyone his personal representative or trustee in bankruptcy should succeed to his interest.

On Page 661 in that case the courts said:

> "* * * Substantially resembled a corporation in its organization. That is to say, the Articles of Agreement secured centralized management, title to the property embarked in the undertaking as to the lease in an individual with provision for his

> succession and as to the equipment in a board of three 'Managers and agents' with provision for their succession, security from the termination of the enterprise by reason of the death of any beneficial owner; facility of transfer of the beneficial interest without affecting the continuity of the enterprise and limitation of the personal liability of the subscribers."

This, of course, is an entirely different situation than the limited partnerships in the case at bar. In the *Poplar Bluff Printing Company v. Commissioner* case, *supra*, the court has an interesting comment to make which we set forth herein:

> "In an ordinary copartnership each partner represents his fellows and within the scope of the common enterprise may by his acts impose liability upon them. When, however, the associates so organize themselves that no representation action may be taken normally except *by elected officials* the association has taken on qualities of a corporation as distinguished from a partnership," Emphasis ours.

The respondents suggest that this is an excellent analysis of the difference between the partnership as herein constituted and a representative management as is contained in a corporate structure, and in this *Poplar Bluff Printing Company* case the facts show that in every respect the structure not only resembles but was entirely identical with a corporate structure that was carried over from the dissolution of a corporation. In other words, after the corporation was dissolved the stockholders carried on with elections and under the same structure except for the actual incorporating

as they had before. There can be no question but this was actual resemblance to a corporation.

On Page 56 the Petitioner continues; in any event, he says the proposition is well established that for the purpose of determining whether an organization constitutes an association where parties operate under an instrument their relationship is governed by the powers conferred by the instrument rather than what the parties may have thought or even have done, and cities *Wholesalers Adjustment Company v. Commissioner*, 88 F. (2d) 156, 157 (CA 8) and also cites *United States v. Holmcrest Tracts, supra*, at Page 152.

The respondents have no objection to the statement of the law, it seems to be the holding of different cases cited, but, it isn't what could be done under the trust and not what is done, but in this case what could be *legally* done under the law under the partnership agreement. But, of course, petitioner has obscured and hidden that fact and that element in this case.

On Page 57 the petitioner cites a number of cases all along the same line, most of them, if not all, trusts whose functions were in a framework quite similar to a corporate structure and which cases hold as already stated that the tax consequences cannot be escaped by declining to exercise powers which the instrument of its creation permit. However, it isn't that Article X of the Limited Partnership Agreement contained powers which the partners declined to exercise, but rather that it contained powers which were unlawful for the partners to exercise.

It might be interesting to state at this point that as the court has no doubt observed there were *two* limited partnership agreements. The second limited partnership agreement created on June 30, 1943, was formed on substantially the same basis as the former one excepting that three additional children were brought into the partnership as limited partners, namely two daughters of George Johnson and a daughter of Albin Johnson. The capital of the general partners remained at $20,000 each (R. 673).

The point that there were two limited partnerships show what the partners themselves considered they could do in amending their organization under the laws of the State of Washington. It is obvious they came to the conclusion that no matter what the provisions were in the original agreement for the taking in of additional limited partners that when new limited partners were actually taken into the organization that an entirely new partnership was created and therefore the new articles of partnership or certificate of partnership, as it is called, under the law existing at the time, was created simply to take in these three new limited partners.

Petitioner cites the *Glensder Textile Co. v. Commissioner* case, *supra*, in pointing out that the tax court *minority* was, he argued, correct in stating that that case was decided in 1942 prior to the Supreme Court decision in *Commissioner v. Tower* and *Lusthaus v. Commissioner*, *supra*, and that at that time a Board of Tax Appeals "was not confronted by the juxtaposition of the family partnership rule with the sim-

ilarity of limited family partnerships to corporations and hence it cannot be regarded as controlling this question. It is for that reason, he argues, less persuasive than a more recent decision of this court holding certain family limited partnerships to be taxable as corporations," and he cites Giant Auto Parts, Ltd., 13 T. C. 307 and he goes on to say instantly by agreement the parties here obtained the advantages of corporate similarity which the Ohio State statute in the cited case of *Giant Auto Parts v. Commissioner*, 13 T. C. 307 afforded the family limited partnership association therein involved.

As respondent suggested before, this is the attempt of the Commissioner to make a new and second concept of the law of partnerships. The first strange concept having been ruled out by the Culbertson case, he now wants to make another new and strange concept taxing limited partnerships as corporations.

Respondent believes that it is safe to say that the *Giant Auto Parts Ltd.* case is one of the few, if not the only limited partnership case ever held to be an association taxable as a corporation. It is necessary before even reading the facts of the case to understand the Ohio State law covering the organization of limited partnerships, at least as they existed at the time the Giant Auto Parts, Ltd., limited partnership was formed. Sections 8059 to 8078 of the Ohio code provide substantially for the creation of a limited partnership and provides for election of managers and officers, the limited liabilities of partners, the transferability of interest, the manner in which the partnership may hold

title to property and bring suits, etc. There is also under the law itself insured continuity of the enterprise uninterrupted by any transfer of a member's interest whether by sale, debt or bankruptcy. 8066 and 8067, Ohio General Code.

Section 8063 of the Ohio General Code provides that the personal liability of members is limited to their respective subscription of capital. Under the provisions of this law itself it would appear that no limited partnership organized under this law could be anything other than an association so closely resembling a corporation as to defy the detection of difference. Except perhaps the office of the state in which the articles are filed and the amount of fees for filing the same. Under such a law, the *Giant Auto Parts, Ltd.*, case following it could hardly be held to be anything other than an association taxable as a corporation. There was an election of officers, the interests of the partners were transferred on several occasions, meetings were held to vote upon amendments to articles and motions were duly made, seconded and unanimously approved. It is not necessary to go further in the details of the case to show that this Ohio case was altogether different, both by enabling statute and fact, than the Western Construction Company partnership.

Continuing on Page 58 Petitioner cites *Helm and Smith Syndicate v. Commissioner*, 136 F.(2d) 440, and *Reynolds v. Hill*, 184 F.(2d) 294, which were both trust cases and involved an altogether different set of facts than are involved in the limited partnership at bar. But, using these cases by some weird analogy

Petitioner makes this conclusion, "thus, even though all three general partners should die prior to the expiration of its ten-year period, still reasonable continuity of the business is guaranteed for that period amounting to three lives and being for ten years and similar to the duration defined in business trust cases." This, of course, is absolutely untrue. Where the maker of this brief ever got such a conception of the law is beyond the respondents. Unless the probate laws be ignored and the partnership agreement be construed to create a trust of some kind. Under the laws of the State of Washington in existence at the time that the partnerships here in question were organized, *there could be no continuance of the business at all* upon the death of the three general partners except for the necessary time as provided for in the probate code, cited supra, for the winding up of the affairs.

Here is something else in connection with this theory of the Petitioners that should be brought to the attention of the court. Suppose that the theory of Petitioner that this partnership would continue although all three general partners should die prior to the expiration of its ten-year period were true, which, of course, is not the case. But, for the sake of argument, if it were true, each deceased's partners share under the probate law would become an asset of his estate and would have to be removed from the capital of the partnership. *How unlike a corporation is such a situation in a partnership under the laws of the State of Washington?* There can be just no analogy and certainly no similarity in this respect.

The Petitioner then under his Subsection 4 takes up the question of transferability of beneficial interest. And on Page 59 of his brief cites under Paragraph 12 of the Certificate of Limited Partnership (R. 668-669) the following.

> "The interest of all the limited partners herein may be transferred upon the approval of the general partners to accept a new assignee as a limited partner in this co-partnership and not otherwise."

And he further quotes Paragraph IX (R. 669):

> "The General Partners are hereby given the right to admit additional limited partners in the future upon the agreement of the general partners hereto but in no event other than a cash contribution to the partnership and upon the same terms as herein expressed."

And, again Petitioner cites Mr. Smith from 34 California Law Review, supra, on Page 533, where Mr. Smith observes:

> "Reasonable restrictions on the transfer of corporate stock are both lawful and common, but it seems that any absolute prohibition against all transfers of stock would be void as against public policy at least under normal conditions. This requires the conclusion that reasonable restrictions on the transfers of beneficial interests in an unincorporated enterprise are not very important; but it would not be unreasonable to hold that a spendthrift trust which contains an absolute and inescapable prohibition against transfers of beneficial interest is so unlike both the law and the practice

> of corporations that it should not be classified as a corporation for the purposes of taxation."

Mr. Smith seems to be nebulous and inchoate in this conclusion. Take that phrase, "This requires the conclusion that reasonable restrictions on the transfers of beneficial interests in an unincorporated enterprise are not very important." Just how he arrives at this conclusion he does not explain and since by the Uniform Stock Transfer Act, in effect in Washington, R.R.S. 3803-101 through 125, there can be no restrictions on the transfer of shares of stock it seems that he and the law have departed one from the other. However, in all fairness to Mr. Smith it would appear from his reasoning and also from the Petitioner's theory that since holders of common and preferred stock in corporations may enter into agreements, such as voting trusts, proxies, etc., that they conclude that this makes a corporation similar to an unincorporated enterprise that restricts transfers of beneficial interest in the Articles or document that creates the enterprise itself. However, Mr. Smith later on in his article makes a much clearer analysis of the situation, but, of course, the Petitioner does not give us the benefit of this clearer thinking on the part of Mr. Smith. Let us cite Mr. Smith's final conclusions on the matter from his Law Review article on Page 534:

> "A business corporation may or may not provide for selection of Directors by all the beneficial owners or for unlimited transferability of its stock or for limitation of the personal liability of officers, directors or stockholders. A corporation may or may not hold legal title to the property

used in its business. All these matters may be molded by charter provisions, by-laws and contracts into almost any form which the particular parties believe will best serve the needs of their particular enterprise, *but continuity, centralized management and something less than an absolute prohibition against all transfers of beneficial interest are fundamental traits of a corporation which cannot be eliminated by the parties without doing violence to well-established principles of corporation law.*" Emphasis ours.

We wonder why Petitioner did not give the court the benefit of Mr. Smith's final conclusions on this subject. Undoubtedly, it was because the Petitioner did not realize that Mr. Smith was speaking of a business corporation and not of a partnership and feared that the phrase "and something less than an absolute prohibition against all transfers of beneficial interest," which is the exact situation contained in Provision 12 of the Certificate of Limited Partnerships herein.

Respondents wish to point out that Mr. Smith undoubtedly was correct as far as he went and since he doesn't refer to partnerships at all, but only a business corporation, he is undoubtedly right.

Certainly the provisions above cited of the Limited Partnership articles in the case at bar are totally dissimilar, unlike and bear no resemblance to the stock structure of a corporation and are furthermore altogether unlike any of the trust cases cited by the Petitioner. The Petitioner on Page 61 then takes up his fifth subsection, the Limitation of Personal Liability. Of course, the limitation of liability of the limited

partners is set forth in the statute, supra. The liability of the general partners is unlimited. Realizing this, the Petitioner tries to sidestep it by saying, "However, it has frequently been held that complete limitation of liability is not an indispensible characteristic for corporate resemblance," and cites *Helm and Smith Syndicate v. Commissioner*, 136 F. (2d) 440.

All the court did in that case was to say:

> "Even if so limitation of the beneficiaries liability is not *sine qua non* of the corporate analogy."

But, in a partnership, respondents urge, there is quite a different situation, because as provided for in the laws of the State of Washington, the title to any property, the ownership of the property can only be held by and through the general partners whose liability was unlimited. They were the only ones that could sue or be sued.

Here is another interesting feature in regard to the limitation of personal liability. In the partnership act as it existed at the time these limited partnerships were organized a limited partner might also become liable as a general partner. (We print it below again as a Footnote, although it has been cited before.)

R.R.S. 9971

9971. Name of firm—When special liable as general partner. The business of the partnership may be conducted under a name in which the names of the general partners only shall be inserted, without the addition of the word "company" or any other general term. If the name of any special partner is used in such firm with his consent or privately, he shall be deemed and treated as a general partner, or if he personally makes any contract, respecting the concerns of the partnership, with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contract he acted and was recognized as a special partner only.

Re-reading this provision of the law, the court will immediately see that in the event a special partner oversteps certain bounds he becomes a general partner and his limitation is removed. If he allows his name to be used in the firm, he shall be deemed to be treated as a general partner or if he personally makes any contract respecting the concerns of the partnership with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contracts he acted and was recognized as a special partner only. So that, in the instant case, we have a peculiar provision riding upon the head of every limited or special partner. Certainly, a contingent liability that is not in any way analogous to any provision of corporate law as it effects the right of a stockholder.

Petitioner on Page 61 of his brief repeats a pat little situation which he first uttered on Page 32:

> "In fact if the general partners were thought of as common stockholders and the special partners as holders of participating preferred stock, the entire arrangement would be identical in all respects with a corporate structure except for the unlimited liability of the general partners."

This is error exaggerated beyond belief. Ignoring for the purpose of the argument the finding of the tax court that this partnership was a bona fide partnership, let us see what other finding the tax court made that bear upon this present argument:

> "There was no delegation of authority by the limited partners to the general partners. The lim-

ited partners held no meetings regarding such delegation of authority, elected no officers and representatives and received no certificate or other evidence of their contribution as limited partners other than the partnership articles. (R. 681.)"

"The limited partnership was not operated with any of the usual formalities of a corporation or association. There were no officers, no regular or formal meetings, no by-laws, no board of directors, seal or minute books. The Western Construction Company held itself out to the public as a true Limited Partnership. The parties to the Limited agreement here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business of the partnership. It was not an association taxable as a corporation. Proper statutory notices of formation of both Limited Partnerships was given. The Limited Partnership agreements provided that the general partners could admit additional limited partners and continue the business on the death or retirement of a general or limited partner. Those rights could be exercised only by agreement among the general partners. (R. 681-682.)"

These findings would seem to be conclusive, certainly no error has been pointed out in them by Petitioner except his theories as to the ultimate conclusions. However, for the purpose of argument let Respondents point out in detail that the Limited Partnership does not bear the slightest resemblance to a corporation:

1. The partnership owned no property. Property under the law was owned by the partners as shown by the tax returns the partnership made, the partnership made the necessary tax returns

but the taxes were paid by the general and limited partners. The partnership set forth, supra, could not bring suit in its own name or be sued in its own name.

2. There was no centralized representative management or management of one or more persons acting in a representative capacity. Here we have only partners acting in the traditional and historical sense as partners, each one liable for the whole partnership debts (that is the general partners), and certainly they were not as has been pointed out in different cases, supra, elected, chosen or acted in any representative capacity other than that of true partners and for this court to hold that there was a centralized management by three general partners who, under the law, of the limited partnership could be sued and were joint and severally liable would be to form a new and strange concept of the law of partnerships for tax purposes, the very thing that Justice Frankfurter and Chief Judge McGruder warned against.

In the *Glensder Textile Co. v. Commissioner* case, 46 B.T.A. 176, supra, the Tax Court analyzed this situation and said:

> "There was centralized control by the general partners but this fact did not make them analogous to directors of a corporation. They were acting in their own interest as hitherto, which constituted five-twelfths of the partnership and not merely in a representative capacity for a body of persons having a limited investment and a limited liability."

This, of course, isn't a trust company case and both

Smith and Petitioner are confusing those cases with partnerships. The Limited Partners here had no right whatever to vote upon the managers, to remove them or to do any of the things that a stockholder is privileged to do under the corporation laws of the State of Washington. None of the limited partners could, of course, have the privilege of cumulative voting or even call a meeting of the limited partners alone or of the general partners. They had no representative rights at all. Uniform Business Corporation Act, R. R. S. 3803-1 through 3803-50.

In the case of *Hecht v. Malley*, 265 U. S. 144, cited by Petitioner, which was a Massachusetts trust case, it was said on Page 159:

> "It would be a wide departure from normal usage to call the beneficiaries here a joint stock association when they admitted not to be partners in any sense. * * *"

This is one of the tests that Petitioner continually overlooks and that Mr. Smith does not deal with in his article and that is that as we have stated heretofore many times, that where you have a real partnership you have a situation altogether different because *of the meeting of the minds of the partners*, the agreement between them. The joint venture in itself, the historical value of the relationship and the new modified limited partnership uniform code which is becoming so popular with the different state legislatures, already adopted by 32, supra. That this entity when it exists although it may have the faint similarity to a corporation in that it is engaged in business, nevertheless is an entity

of its own and must not be confused with these loose trust arrangements, pools and other associations which the Commissioner tried to reach in his regulations, supra.

If the test that Petitioner seeks were to be adopted by the court, that is to say that the general partners with their unlimited liability were to be designated as representatives of the joint enterprise simply because they are the general partners, then, of course, every limited partnership in all of the 32 states and states that have similar partnership law would be in a trap of tax consequences with the exception of the State of Ohio, whose code is so different.

Such a decision would subject all of the limited partnerships formed under the laws of these different states to taxation as a corporation. *There can be no question about this consequence.*

3. The third point, the continuity of the partnership, has been gone into so thoroughly before in this brief that Respondents simply wish to repeat that there was no continuity of the partnership as a whole possible, but for a limited time after the death of one of the general partners or even of a limited partner, under the probate laws of the State of Washington then in existence. It will be noticed that there is no distinction in the probate laws of the State of Washington between a limited partner and a general partner. However, under the Uniform Limited Partnership Act, R. R. S. 9975-80, enacted two years after the last Limited Partnership herein was formed, there was a change in the act which permitted limited partner-

ships to continue after the death of a partner if there are special provisions covering the same in the articles of copartnership. This was not the case, however, in the law at the time of these instant partnerships.

The *Glensder* case, *supra,* had a much weaker structure as far as this feature was concerned and also other features, but the Tax Court held that the *Glensder* case was not an association taxable as a corporation.

4. Point Number 4, the transferability of beneficial interest is rather simple. Suffice it to say, there were no certificates of interest whatever, the only right the limited partner had was that expressed in the certificate and that, of course, under Section 12 of the certificate, his interest could be transferred only upon the approval of the general partners to accept a new assignee as a limited partner in this copartnership and not otherwise. This provision certainly fits the test cited by Mr. Smith, whom, it will be remembered, stated succinctly:

"* * * And something less than an absolute prohibition against all transfers of the beneficial interests are fundamental functional traits of a corporation which cannot be eliminated by the parties without doing violence to well established principles of corporation law."

5. Limitation of Personal Liability. Unless the courts are going to throw out the principle of limited liability as contained in all of the Uniform Limited Partnership laws and all similar limited partnership codes, then the limitation of the special partners is not to be controlling. The control-

ling feature would be whether or not the managers or the general partners had a limitation of liability and here, we believe, is one of the tests that has been truly applied in most of the cases. There may be one or two exceptions where all of the other attributes of a corporation were present, but in at least all but one or two of the cases cited in Petitioner's brief and in nearly all the trust company cases is the *significant fact* that the trustees or managers of the enterprise had limited liability. Here, as in the historical partnership, general partners have no limitation whatever on their liability as a general partner and this must be one of the controlling features, that difference between a partnership and a corporation that cannot be ignored or easily explained away.

Respondent submits that if a jig could be made, as is done in a factory, and one jig could be labeled corporation and made in the corporate form containing the different essential elements of a corporation, and another jig could be made to form the outline and contain all the elements of a limited partnership, that the two jigs would have irreconcilable differences in their pattern and the two could not fit together one over the other or one within the other.

Again, we have an element not mentioned by Petitioner or Mr. Smith or in fact, considered in many of these cases which, of course, were trust cases, where this particular element would not be contained and that is, as we have repeated again and again, and that is the warm contact between two or more individuals in a joint adventure. We have that in a high degree in the Western Construction Company. Respondents submit

in a higher degree than in most of the so-called family partnerships which have been decided in favor of the taxpayers over the last few months. We have the sincerity of purpose, the desire to form a partnership and that alone, that true partnership principle, makes a jut or a jog in the jig of the limited partnership which throws it all out of line with the corporate pattern.

Also, the limited liability feature of the corporate structure throws it entirely out of line with the general liability of the general partners. The corporate structure must own or hold title to its property. It sues or is sued in its corporate name. Even a lease could not be made in the name of the limited partnership under the laws of the State of Washington then in force. The lease would have to be drawn in the name of the general partners. There was no representative committee or trustee, or manager, as is the fact in most of the cited cases in appellant's brief. We have only the historical general partner. The limited partners had no easy way of selling their interest or transferring it, in fact, it could only be done upon the agreement of the three general partners. See Tax Court Findings, supra. Respondents submit that not only the Tax Court, the trier of the facts, made a finding that the partnership here was not an association taxable as a corporation, but has supported that finding by the other findings set forth above, each one conclusive of the fact that under the principles set forth in the Morrissey case, supra, that these partnerships could not be construed to be an association taxable as a corporation, but that the law itself must conclude, if it is a question of law,

that there was no association here taxable as a corporation.

Petitioner isn't satisfied to rest with his Morrissey case test, but now has to go on into the stratosphere to work out the last perspiration in his theoretical pores regarding the mythical corporate likeness of Western Construction Company. He cites *State ex rel. Range v. Hinkle*, 126 Wash. 581, 219 Pac. 41, wherein the Supreme Court of Washington quoting the state Constitution expressed the following on Page 583:

> "Under constitutional provisions similar to Section V, Article XII, supra, it is almost uniformly held that joint stock companies and limited partnerships organized under statutory authority are in fact corporations."

This case decided so long ago has caused the Supreme Court of the State of Washington some trouble ever since on account of this ill-considered statement, but finally the court in the case of *Haynes v. Central Business Property Company*, reported in 140 Wash. 596, on Page 599, made the following ruling:

> (1) The appellant's first position is that the association of unit holders as created by the trust deeds is a common law trust and illegal. There are two reasons why this position cannot be sustained, the first of which is that, if a common law trust exists and is assuming to exercise the powers and functions of a corporation, *the state is the only one that can complain. Frost v. Puget Sound Realty Associates*, 57 Wash. 629, 107 Pac. 1029. In the case of *State ex rel, Range v. Hinkle*, 126 Wash. 581, 219 Pac. 41, the state resisted the application

> of the realtor for a certificate entitling it to do business as a common law trust, and in *State ex rel. Colvin v. Paine*, 137 Wash. 566, 243 Pac. 2, 247 Pac. 476, the action was brought on behalf of the state."

This would seem to answer completely the theory of the Petitioner in this respect.

Respondent's note that on Page 63 and 64 that Petitioner ends up his dissertation regarding the theory that the partnerships in this matter are associations taxable as corporations with a complete dive into nomenclature.

Respondent don't believe that this court is interested in form more than substance, but the fact that the Petitioner has to make a dive into words signals the weakness of his theory. Petitioner refers to the Washington Statute and to the phrases "common stock" and "capital stock." Petitioner also refers to Remington's Revised Statutes, Sections 9972 and 9968 which provide:

> "No part of the capital stock thereof shall be withdrawn," etc.

and also:

> "The amount of capital which each partner has contributed to the common stock."

These same phrases and the same provision is contained in the Uniform Limited Partnership Act, but in the statutes in force in the State of Washington applicable to the partnership herein these provisions simply meant the total interest of the partners and each partnership share or beneficial interest in the partnership as a

whole. They could mean nothing else. There was no stock and no certificates of stock.

To refresh the court's memory again, R.R.S. 9973 provides:

> "All actions, suits, or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships. * * *

Taking the laws of Limited Partnerships of the State of Washington as a whole at the time these partnerships were created, there certainly cannot be any construction that there was capital stock similar to that of a corporation whatsoever. The use of these phrases and words by appellant is but a forlorn adventure in nomenclature.

CONCLUSION

Since Respondent has already in the first section of his brief gone into the questions of the actual partnership of which the limited partners were component members, the Petitioner's argument beginning on Page 64 shall be answered briefly.

It is significant that since the *Commissioner v. Culbertson case, supra,* and, indeed, the decision in the case appealed from herein, that there has been a number of family partnership cases cited by the tax court and several of them appealed from the Tax Court and decided by the different Circuit Courts of Appeals.

Petitioner has cited only four cases since the Culbert-

son case, and one of these cases was a District Court case, *Toor v. Westover*, 94 F. Supp. 860 (S. D. California).

In the concluding pages of this brief Respondents will list a great many of the cases which have been decided by the Tax Court in favor of the taxpayers where the facts, respondent believes, are much weaker than the facts in the case at bar, and Respondent has already cited in this brief the following cases decided by different Courts of Appeals after the *Culbertson* case: *Lamb v. Smith*, 183 F. (2d) 938; *Cobb v. Commissioner*, 185 F. (2d) 255; *Ginsburg et ux v. Arnold et al*, 185 F. (2d) 913, and will cite two others later.

The *Ginsburg* case, the court will recall, is the case where the father gave interests in the partnership to a son and two daughters, paying a gift tax on the transaction.

Let us now examine the four cases cited by Petitioner. However, we should have mentioned that in addition to the four cases since the *Culbertson* case was decided, on Page 65 the Petitioner goes back to the *Tower* case and quotes a part of the Supreme Court's ruling on that case. However, it will be remembered by this court that the facts in the *Tower* case were altogether different from the facts in the case at bar. The *Tower* case was one of those husband and wife partnership attempts where there was no change at all in the situation of the husband and wife before and after the purported partnership agreement was made. The husband controlled all of the business and all of the income as he had before. There was no change in

the bookkeeping, the wife drew no dividends and the only drawing she made was the same as she had before for living expenses, etc. It is obvious that no court in the examiation of the facts in the *Tower* and *Lusthaus* cases would hold that these cases were true partnerships.

In the *Crosley v. Campbell case, supra,* the court said on Page 642:

> "This court stated in *Greenberger v. Commissioner,* 177 F. (2d) 990 on Page 994, C.C.A. 7, "The court in the Culbertson case left no doubt that the predominant factor is the good faith and the legitimate purpose of the parties in forming a partnership. * * *"

That seems to succinctly sum up the *Culbertson* case ruling and respondent submits that in this case the intent, good faith and purpose of both the general partners and the limited partners cannot be other than found to be in support of the Court's findings that it was a valid and bona fide partnership.

The Tax Court heard the witnesses on the stand, had a chance to observe their demeanor and test their credibility.

The only thing Petitioner does is to make conclusions of his own, such as, "the record is replete with indicia that the parties did not intend to join together with a business purpose in the conduct of a partnership," but Petitioner does now show the court the facts that support such a conclusion. Indeed, the facts that Petitioner does set out conclusively support the findings of

the Tax Court. Let us examine them. On page 67 in the second paragraph, the Petitioner says:

> "And while the sons contributed engineering skill which the general partners lacked of substantial value to the partnership, such services as they did perform were in part at odd hours and in addition to regular employment elsewhere were under the direction of the general partners."

Now, what is wrong with that? In several of the cases above cited, the family partners contributed no services or influence. Here we have engineers contributing valuable services, and while those services were rendered after hours that does not make them less valuable, or does it make their intention less true and honorable. In fact, does it not strengthen the intention and good faith of the parties rather than weaken it?

Petitioner says that the Tax Court found that the daughters did not render any services to the limited partnership of any substantial consequence. Well, they signed notes, promissory notes, that were absolutely good and collectible. It will be remembered that no daughter or son was taken into the limited partnership until they had reached their majority and would be legally liable on the note. If, a general partner had died at any time before the notes were paid, Petitioner would have to admit that the administrator or executor of the general partner's estate certainly would attempt to collect that note and that the daughter would have to pay it, whether or not she had any assets of the Limited Partnership to draw from or not. It will be re-

called that there was no provision, as there is in some of the cases, that the notes were to only be paid out of partnership profits. They were to be paid without any restriction of any kind. It was simply a straight promissory note without any change in usual business form.

And, the court found that the general partners used these notes for the purpose of securing credit and the fact is found that they did get an additional loan of $50,000 after the notes were accepted by the Fathers, the general partners. But this partnership goes much further. As the trial court set forth these older men wanted to have their sons in with them. They made an attempt once before to get their sons to join them in the partnership. On January 6, 1941, Articles of Copartnership naming six individuals as partners were prepared and executed. This partnership, however, was never actively operated and no books or accounts were ever set up for it. (R. 663-664.)

After that the first limited partnership agreement was made and the court found:

> "* * * But rather the result of many years of thought by the general partners who were anxious to have their sons, daughters, and sons-in-law come into the business so that it would continue after the general partners retired or died." (R. 676.)

For the benefit of Petitioner who used this finding to suggest continuity of the enterprise, may we remind the Petitioner that it was just that, the continuity of the *enterprise as the court said* "come into the *busi-*

ness so that it would continue" not the *partnership*. There is a legal distinction.

Petitioner doesn't seem to like the dream that Winston Johnson testified to. He set it forth in his brief on Page 51 and we urge the court again to read it. Here is evidence of good faith. Certainly the Judge who heard this young man testify on the stand probed his very heart and knew that he was telling the truth, or that Judge would not have held for respondents, as he did.

There can be no question, it seems to us, from this record that the only reasonable inference and conclusion that could be gained from these facts is that the decision of the Tax Court is without error in all respects.

On Page 66 the Petitioner cites the case of *Maytag v. Commissioner*, decided March 21, 1951, (C.C.H. Federal Estate and Gift Reported, Paragraph 10,800). In this case the Court of Appeals for the Tenth Circuit said, referring to the Tax Court:

> "Finding must be treated as clearly erroneous if based upon substantial error in the proceeding, if unsupported by any substantial evidence, if contrary to the clear weight of all the evidence or if supported by evidence, but the court of Appeals in reviewing the entire evidence entertains the definite and firm conviction that a mistake has been committed."

Certainly, respondent can't find much objection to the statement of the law; certainly a finding would have to be erroneous if based upon substantial error

in the proceeding and if unsupported by any substantial evidence, particularly if contrary to the clear weight of all the evidence.

On Page 69 and 70 of his brief, Petitioner is evidently thinking that this court might be influenced by the amount of profit that was estimated to be made upon the 40 per cent completion of the contract as referred to before, so he sets out the figures again and then draws the unreasonable, impractical, unique and novel conclusion:

> "In view of the foregoing it seems clear error for the Tax Court to have found that the $60,000 credit which the children contributed in this unusual and circuitous manner was of any substantial importance to the financial status of the business or of the general partners."

The trial court has found and certainly this Court has practical knowledge of such things, that with the assistance of the notes another $50,000 in a loan from a bank was obtained. Let me suggest to Petitioner that without this additional $50,000 to the already owing $80,000, it was quite possible that the jobs would not have been completed and there would have been no profits made but rather a tremendous loss sustained. That there is no comparison in the amount between the new credit obtained and the profits that were finally made. This isn't a matter of interest upon money. As we have said before the trial court found:

> "The construction company represents a hazardous financial risk and it is possible to lose heavily as well as to realize large profits."

And, Petitioner's statement that the capital which the children contributed "in this unusual and circuitous manner" is remarkable in that it was a pure business transaction with regular promissory notes instead of the gifts which so many of these other cases have as a part of the facts in the case. Nevertheless, the courts have accepted the gift from the fathers to the children as an element of a true partnership. The *Ginsburg* case, *supra,* is one of them. So respondents inquire, what is this unusual and circuitous manner?

Then Petitioner uses the phrase in the next paragraph:

> "Pending profits on the partially completed Government contract."

Respondents submit that there is no such a thing as *pending profits* on *partially* completed government contracts. There is only a sure profit on the completed government contract.

It might be well at this point to remind the court that, as the trial court found:

> "They endeavored to persuade other companies to join them on bids but the West Park Project at Bremerton indicated that this was not a satisfactory solution. They also tried unsuccessfully to get outsiders to invest in the partnership. Thus faced with the desire to include their children in the business and with the need of additional financial backing the brothers decided to form a Limited Partnership in which the brothers would be the general partners and their adult children the limited partners." (R. 664)

It might be well to support the finding of the court with the testimony of George Johnson.[4] (We are putting this as a footnote taken from his testimony (R. 290, 291, 292).

Respondents might mention that not only was this the testimony of one of the general partners, but that Frank Oscar Granston was put upon the stand as a

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[4]Q. Now, will you tell the court the reasons you had for the formation of the limited partnership?

A. Well, we were constantly looking forward to being able to take the larger work. But before it was well to take a plan and start and figure, you had to contact people to see if they would furnish a bond in that amount, and most of the time we heard, "No." So we were not able to reach the goal or even start to figure on it. So we called in Philip Johnson of the Boeing Company, because we knew him pretty well. We had built his home and after considering it a little bit why he said, "No," he was going to use his money elsewhere, and we found out that he was not interested.

Q. I am not quite sure that I understand you. You called in Philip Johnson, you say?

A. Yes, sir.

Q. For what purpose?

A. And asked him if he would be willing to put in $25,000 or $50,000 with us—if he would not invest some money with us.

Q. Are you referring now to the partnership?

A. Into the partnership—yes.

Q. All right.

A. But he answered us declining that request.

Q. Do you know where Mr. Johnson is now—Philip Johnson?

A. Mr. Johnson passed away a few years ago.

Q. Go ahead.

A. We then asked Clyde Phillips who was also at that time one of the bonds salesmen here in Seattle, if he would take some of his private money and put it in with us, because he was furnishing bonds for us. But he could not furnish the bonds for the jobs that we wished to figure on. Well, he, of course, would have put in money with us, but, of course, he would have wanted such a huge part of the partnership, so that we would have been working for him rather than for the Western Construction Company. So then we saw Granston of the University Plumbing Company.

Q. The gentleman that just preceded you on the stand?

A. Who just testified, yes, sir. We have known him very well for many years. But, of course, he has a business of his own and, of course, naturally, he wants to have enough money so that he can paddle his own canoe. and he might also have thought, "Well, it is not so sure to invest the money in general contracting because it is—you don't make money on every job you take. It is a risk."

Q. Well, did you succeed in getting any capital in?

A. No, we did not.

witness, one of the men whom the general partners approached with a view of getting money from him. (R. 285, 286.)

If, instead of having inadequate finances to take these big jobs, the general partners had had substantial financial reserves to go into these contracts the Petitioner might find some substance to his arguments about the profits, but the fact, of course, was altogether different. But, even so, suppose that the general partners had substantial financial reserves at the time the limited partnerships were organized. Would that fact change the good faith and intent that was manifest in this record in the organization of the limited partnership and cause this court to reverse the tax court on its finding that this was a bona fide and real partnership? Respondents submit that it would not and that with the further financial need of the general partners that this record is clear that there was not, as Petitioner intimates, a melon of some sort to be cut and all profits were made and everything was done that should be done but that a subterfuge had to be entered into in order to reduce taxes.

The trial court went into that matter quite thoroughly and made this finding:

> "This decision was made without discussion with tax counsel, accountants, or attorneys as to whether it would be cheaper to do business as a partnership rather than as a corporation." (R. 664.)

Petitioner in this third paragraph on Page 70 says that some of the limited partners withdrew their share

of the profits but the majority actually did not withdraw a great deal of their profits as the tax court found. On Page 22 and 23 of Petitioner's brief he has set out a number of substantial amounts withdrawn by the partners. One partner withdrew $6,000 more than he had to his credit. Other partners withdrew amounts such as $36,000, $49,000, etc. It is true, of course, that the limited partners paid their income tax and paid them out of profits. What possible point can Petitioner make of that?

Finally Petitioner cites *Stanback v. Robertson*, 183 F.(2d) 889, C.C.A. 4, and Respondents believe makes a very misleading statement. Petitioner says:

> "For similar reasons limited partnerships were not recognized for tax purposes."

The *Stanback* case was a collateral estoppel case. The court on Page 894 said:

> "* * * Here the precise issue before us has not been previously adjudicated and even if it had been, the law applicable to the situation had been altered by supervening decisions of the Supreme Court."

By supervening decisions of the Supreme Court the court referred to the *Culbertson* case, *supra*, so that it is clear that this case has no bearing upon the instant matter at all, and we might add that in that case a jury in the district court had held against the partnership.

The next case immediately following the statement "for similar reasons limited partnerships were not

recognized for tax purposes" is the district court case of *Toor v. Westover*, 94 F. Supp. 860, Southern District of California, Central Division, Judge Yankwich, District Judge. It is only necessary to cite from Judge Yankwich's opinion to clearly distinguish the *Toor* case from the case at bar. The judge says on Page 863:

> "Granting that a limited partnership may be created, California Corporation Code Section 15507-15518, so as to benefit from the provision of Section 181 of the Internal Revenue Code, I am of the opinion that * * * including the amount allocated as profits each year was so exclusively under the domination of the plaintiff that to all intents and purposes the creation of the partnership made no change whatsoever in the manner in which the business had been conducted before."

Petitioner's concluding case, *Lamb v. Smith*, 183 F.(2d) 938, decided April 17, 1950, in which a jury verdict sustaining a limited partnership was under scrutiny, does not give any comfort to the Petitioner and the Petitioner's statement:

> "And hence the scope of review was more limited than here where the fact finding may be set aside for clearer error."

does not give the court or respondent any idea of what Petitioner is driving at. An examination of the case shows that the jury, of course, was sustained in its finding and the court said on Page 942:

> "The rule stated applies in tax cases where the government challenges the existence of a partnership for tax purposes. In determining whether there was a true partnership for 'income tax pur-

poses,' the fact that there was no contribution of 'original capital' or 'vital services' is to be taken into consideration, but it is not conclusive."

And on Page 642, the court says:

> "The finding of fact that there is (or is not) a partnership by the trier of the facts (tax court or jury) if supported by the evidence is final. *Davies v. Commissioner,* C.C.A.(3d) 161 F.(2d) 361."

However, Petitioner should not mislead the court. The *Lamb v. Smith* case was not reversed on the verdict of the jury for reason of any partnership question. The case was remanded and sent back to the trial court *because the wife had filed a joint return with the husband.*

Since dictating this brief, the respondents have located several recent cases in late Prentice-Hall Tax Service Bulletins.

The case of *Edward A. Ardolina v. Commissioner of Internal Revenue,* decided in the United States Court of Appeals, Third Circuit, No. 10,197, decided January 2, 1951, 72,212 P-H, Fed. 1950.

> "The Tax Court's ultimate finding of fact that petitioner and his wife did not actually intend to join together as partners in the conduct of the enterprise is clearly wrong.
>
> "The decision of the tax court will be reversed."

Acting Collector of Internal Revenue v. Harry B. Green and Augusta M. Green, U. S. Circuit Court of Appeals, Fifth Circuit, No. 13,144, January 10, 1951, 72,227, P-H Fed. 1951. The facts briefly are that the

minor daughters put in capital *by promissory notes,* where were paid off with *business income.* The Collector of Internal Revenue appealed from the District Court finding that the partner taxpayer and his daughter had intended in good faith to form and had in fact formed a valid partnership. The collector insisted that the findings were wholly erroneous; the court said:

> "* * * We cannot agree. The partnership, though made with minors, was valid under tax law. So valid, it was valid, against the claim of the commissioner, unless it was entered into not in good faith but as a sham or pretense. The district judge, upon evidence sufficient to support his findings, has found good faith in law and in fact. We cannot, on this record, set these findings aside as clearly erroneous.
>
> "The judgment is affirmed."

Counsel for Petitioner certainly must shudder at the very thought that here *minor daughters* gave notes and were held to be true partners. How much stronger is the case at bar where adult responsible daughters and sons gave notes which were used to obtain monies for the good of the partnership.

The following United States District Court cases are recently reported showing family partnerships recognized for tax purposes either by jury or by District Court judge:

Archibald Sparks Brown, Sr., v. William E. Davis, U. S. District Court, Southern Division, Northern District of Alabama, 6470, November 13, 1950, 72,398

P-H Fed. 1951. Wife, daughter and son gave notes and neither child nor wife rendered vital services.

J. A. Morrison, Jr., v. John L. Fahs, individually and as United States Collector of Internal Revenue for the District of Florida, U. S. District Court, Southern District of Florida, Miami Division, No. 1271-M, April 2, 1951, 72,394 P-H Fed. 1951. Taxpayer's mother was recognized as a real partner in the family firm that succeeded father and son partnership. The mother supervised preparation of food, a vital phase of the business.

Lee A. Long v. United States, U. S. District Court, Western District of Oklahoma, No. 4760-Civil, 72,286 P-H, settled 1951. Wife recognized as partner in business that was a valid partnership under state law.

Respondent expected to cite a number of cases decided in the tax court recognizing family partnerships for tax purposes, but found there were so many of them that it would be inconvenient to put them in this brief.

In final summation, respondents conclude as follows: The Commissioner by his Notice of Deficiency took admittedly inconsistent position that: (1) Western Construction Company, the limited partnership, is an association taxable as a corporation, and (2) the partnership entity should be disregarded for tax purposes and all the income attributed to the three general partners.

It would certainly seem that the Commissioner, in taking these inconsistent positions, has succeeded in casting doubts on the presumptive correctiveness of

both. Certainly, he could not be right on both and the Tax Court found that he was right in neither of these inconsistent positions. The Tax Court made the following ultimate findings:

1. The parties to the Limited Partnership agreements here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business as a partnership. (R. 681.)

2. It was not an association taxable as a corporation. (R. 681.)

The findings of the Tax Court supporting the ultimate findings 1 and 2 given above, are as follows:

1. *Bona fide partnership*

(a) The monies which these adult children borrowed from their fathers and used to invest in the limited partnership were bona fide loans. The general partners had minor children but they were not taken into the partnership because they wanted notes from adults fully responsible for payment. The notes were negotiable, bore interest, and were all for short terms not exceeding two years, except the first two notes of Lloyd Johnson and his sister, Bernice Wallin, to their father, George Johnson, for $10,000 each. These notes were installment notes payable in yearly installments of not less than $3,500 in any one payment. (R. 675.)

(b) These notes were never placed as collateral for any loan but they were listed as personal assets of the general partners in application for construction bonds. On July 30, 1942, an addi-

tional $50,000 was borrowed from the bank. (R. 671.)

(c) Each of the children knew and understood he was signing a note which was unconditionally payable and which represented a bona fide obligation on his part. They did not take on these obligations lightly as there was considerable discussion about the notes before signing them. * * * Rachel Gustafson, the daughter of George Johnson, was invited to participate in the first limited partnership. However, she declined to do so as both she and her husband did not desire to sign a note for $5,000. They knew that the construction business was subject to heavy losses, as well as handsome profits. (R. 671.)

(d) Division of such profits was made with the limited partners on the basis of their stated partnership interests. (R. 676.)

(e) The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners who were anxious to have their sons, daughters and sons-in-law come into the business so that it would continue after the general partners retired or died. (R. 676.)

(f) Lloyd did not work as an employee of the limited partnership but he did perform important services for the firm. He was a graduate engineer with a great deal of experience. * * * He did a great deal of night work, helping the general partners on matters relating to engineering, bids and estimates. He did not receive any compensation for this work but he devoted a considerable amount of his time because of his interest as a

limited partner. It was of great value to the partnership. (R. 677.)

(g) Roy Johnson rendered no regular service to the limited partnership until January, 1943, when he devoted full time to its affairs. During this period he worked as an engineer designing layout foundations, excavating footings, roads, buildings, arches and superintending both large and small jobs. (R. 677-678.)

(h) Winston Johnson worked for the partnership at all times after March, 1942, when he was released from the Army. He had had three years of college training as a civil engineer and did various types of work for the firm. (R. 678.)

(i) The partnership profits were regarded by all of the limited partners and their spouses as community property. * * * Partnership checks representing distribution of profits were sometimes made out to the limited partners and sometimes to the spouses of the limited partners, depending upon which one requested the money. (R. 678-679.)

(j) The limited partners were entitled to withdraw their share of the profits as they pleased and the share of the profits credited to the individual partners' accounts were in no wise considered to be anything but their own property. No limited partner ever withdrew any profits and turned them over in any way to the father, the general partner. No limited partner was in any way dependent upon his or her father, the general partner, for support, either at the time of the formation of the partnership or later. (R. 679.)

(k) The freedom of withdrawals by the limited partners without consulting the general partners is illustrated by the various uses they made of their profits. (R. 680.) Illustrations continue on R. 680.

2. *Limited Partnerships were not taxable as corporations*

(a) The three general partners managed the limited partnership in the same manner that they had the business which preceded the limited partnership. As general partners, the management and direction of the business was in their hands and all their personal assets, including the notes of the limited partners, were subject to possible loss in the event the limited partnership failed. (R. 680-681.)

(b) There was no delegation of authority by the limited partners to the general partners (R. 681.)

(c) The limited partners held no meetings regarding such delegation or authority, elected no officers and representatives and received no certificates or other evidence of their contribution as limited partners, other than the partnership articles. (R. 681.)

(d) The limited partnerships were not operated with any of the usual formalities of a corporation or association, there were no officers, no regular or formal meetings, no by-laws, no board of directors, seal or minute book. (R. 681.)

(e) The Western Construction Company held itself out to the public as a true limited partnership. (R. 681.)

(f) Proper statutory notice of the formation of both limited partnerships was given. (R. 681.)

(g) The limited partnership agreements provided that the general partners could admit additional limited partners and continue the business upon the death or retirement of a general or limited partner. Those rights could be exercised *only by agreement* among the general partners. (R. 681-682.)

Under "clearly erroneous" rule Tax Court's findings should stand as to both Ultimate Findings (1) and (2) above set forth.

As to Ultimate Finding (1) not only because specific findings of trial court are unchallenged by Petitioner except for specious arguments as to effect of facts, but because the specific facts are so strong in support of the ultimate finding that had the Tax Court found the reverse, this court, as in the late case of *Edward A. Ardonila v. Commissioner of Internal Revenue, supra*, would have in all conscience been compelled to reverse the trial court on the ground that the ultimate finding was "clearly erroneous."

The specific findings in the case at bar are much stronger, respondents sincerely believe, than any of the cited cases, where the partnerships have been held to be bona fide.

As to Ultimate Finding (2) we have in the instant case a different situation than has appeared in any of the cited cases for the reason that here we have inconsistent tax deficiencies sought for by Petitioner. If Ultimate Finding (1) is affirmed as respondent believes it must be, *then a real partnership for tax pur-*

poses or any other purpose, as Justice Frankfurter finds these situations identical when challenged by the government. Obviously, a true partnership cannot be an association taxable as a corporation.

But, for sake of argument and answering Petitioner's brief, respondents contend that the Ultimate Finding (2) of Tax Court is not erroneous and therefore must stand.

And that in any event both facts and law uphold decision of Tax Court for the reason the tests set out in the *Morrissey* and companion cases, *supra*, applied to the partnerships here in question, show no resemblance whatever to corporations in the sense used in said cases.

1. *Title in a single entry.* Title and any ownership of property under Washington State Law in force at time of partnership organization vested in general partners. No title or ownership in entity. All suits had to be brought by or against general partners. Name has to include General Partners.

2. *Centralized Management.* As Tax Court found (finding (a) under Ultimate Finding (2) *supra*) the three general partners managed business in the same manner as they had before they took in limited partners. Certainly special partners had no choice in their selection or power of removal. Nothing resembling voting power of stockholders. No representative management as defined in "Words and Phrases," *supra*. General partners owned together approximately 50 per cent of partnership assets. Pure historical and

legal partnership management. General partners can act *jointly or singly.*

3. *Continuity of Enterprise.* Under laws of State of Washington in existence at time, even though Articles of Co-partnership provided that general partners could continue business upon death or retirement of a partner, partnership after the time provided by statute, *supra,* must be dissolved and would be by Washington law. Also, if valid, requires agreement of general partners. Question if Court of Equity would enforce provision.

NOTE: *Glensder Textile Company* case, *supra,* under Uniform Limited Partnership Act in State of New York has such a provision for continuance as new Limited Partnership Act in Washington (Uniform Act) does.

In any event, there was no legal and valid provision for continuity and even if the Uniform Code had been in effect no such continuity as provided for in a corporation existed.

Also, deceased partners' interest would be withdrawn from partnership and probated in his estate. And if all three general partners died the partnership was at an end, regardless. No similarity to a corporation.

4. *Transferability of beneficial interest.* No certificates or other evidence of partnership interest. A limited partner's interest could only be transferred by consent of general partners. Meaning agreement by them as found by Tax Court, *supra.* As Smith in Cali-

fornia Law Review, *supra*, said: (Quoted by respondents, petitioner stopped citing from Smith just before this paragraph.)

> "* * * But continuity, centralized management and something less than an absolute prohibition against all transfers of beneficial interests are fundamental functional traits of a corporation which cannot be eliminated by the parties without doing violence to well-established principles of corporation law."

Certainly this provision in partnership agreement meets all tests making it dissimilar to any corporate structure ever conceived.

5. *Limitation of Personal Liability.* The special partners here, similar to limited partners, under the uniform act had limited liability but general partners, whose interest was, in second partnership and intended in first, equal to all limited partner's interest had no limitation of liability. In addition, under then Washington law, *supra*, limited partner could lose his limited status by doing certain things.

In this case, general partners borrowed $80,000.00 and an additional $50,000.00 for partnership use. In event of disaster general partners could have been wiped out. What resemblance does this status bear to a corporation? To common stock as Petitioner suggests on Page 61 of his brief, when he asks you to think of general partners as common stockholders and special stockholders as preferred stockholders?

The answer is obvious. There is marked dissimilar-

ity between the limited partnership such as these at bar and a corporation.

Thirty-two states have adopted this limitation for special partners through the Uniform Limited Partnership Act. Certainly none of these legislatures contemplated that it was creating a form of corporation in so doing.

Respondents believe that in none of these five points does the respondents' partnerships approach that similarity to a corporation that sets them aside into a special category for tax purposes. As Justice Frankfurter said in the *Culbertson* case, *supra*, on Page 754:

> "We should leave no doubt in the minds of the Tax Court, of the Courts of Appeal, of the Treasury and of the bar, that the essential holding of the *Tower* case is that there is 'no reason' why the 'general rule' by which the existence of a partnership 'is determined' should not apply in tax cases where the government challenges the existence of a partnership for tax purposes."

Certainly these partnerships are challenged by the government pursuing a new and strange concept of tax liability as effects a partnership found by the Tax Court to be a true partnership and not an association taxable as a corporation.

The decision of the Tax Court should be affirmed in all respects.

Respectfully submitted,

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